

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF CEDAR     )  
CREEK SEWER CO., INC., D/B/A         ) CASE NO. 9104  
CEDAR LAKE PARK SEWER SYSTEM        )

O R D E R

On July 13, 1984, Cedar Creek Sewer Company ("Cedar Lake Park") filed an application with the Commission to increase its sewer rate pursuant to 807 KAR 5:076. This regulation permits utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative filing method to minimize the necessity for formal hearings, to reduce filing requirements and to shorten the time between the application and the Commission's final Order. This procedure minimizes rate case expenses to the utility and, therefore, results in lower rates to the ratepayers.

On December 19, 1984, Cedar Lake Park filed a letter requesting a conference with the Commission regarding its requested increase. In response to this request, the Commission on January 14, 1985, ordered that a hearing be held. The hearing was held on January 29, 1985, and no intervenors were present, although the Attorney General's Office ("AG") was a formal intervenor in this case.

Cedar Lake Park requested rates to produce an annual increase of \$12,699. Cedar Lake Park stated that the increase was

necessary to eliminate deficit operations and to add a profit margin. In this Order, the Commission has granted no increase in rates.

#### TEST PERIOD

The Commission has accepted the 12-month period ending December 31, 1983, as the test period in this case.

#### REVENUES AND EXPENSES

Cedar Lake Park had net operating income of \$1,119 according to its 1983 Annual Report. In response to a data request by the AG,<sup>1</sup> Cedar Lake Park indicated that test period expenses were overstated by \$274 for labor charges and by \$1,001 for fuel costs, resulting in a revised actual net operating income of \$2,394. In order to reflect current operating conditions, Cedar Lake Park proposed numerous adjustments to expenses in order to reflect more current operating conditions. The Commission has accepted Cedar Lake Park's pro forma revenues and expenses with the following adjustments:

#### Revenue Normalization

For the test period Cedar Lake Park had operating income of \$50,816 from 425 customers. The normalized revenue from these customers at present rates is \$53,805. Therefore Cedar Lake Park's actual test period revenues have been normalized in the amount of \$2,989 to reflect the total revenue based on the number of customers at the end of the test period.

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<sup>1</sup>Response to AG's request of August 15, 1984, filed September 4, 1984.

#### Fuel Expense

Cedar Lake Park proposed a pro forma fuel cost of \$19,032 based on a 7-1/2 percent increase from Louisville Gas and Electric Company. Using the actual test period electric usage and the current rates being charged, the Commission has determined the adjusted level of this expense to be \$18,452 and has, therefore, decreased Cedar Lake Park's pro forma expense by \$580.

#### Chemicals Expense

In response to the AG's August 15, 1984, data request, Cedar Lake Park submitted invoices to substantiate chemicals expense of \$855. Included in this expense were refundable drum deposits of \$200 which are not an operating expense. Therefore, the Commission has reduced Cedar Lake Park's test period chemicals expense by \$200.

#### Amortization Expenses

Cedar Lake Park's test period expenses included \$554 for amortization of rate case expenses incurred in a previous rate case in 1981. Cedar Lake Park stated that the amortization period for these expenses was 1981, 1982, and 1983. The Commission has therefore reduced pro forma expenses by \$554 as this test period expense is fully amortized and will not be incurred on a prospective basis.

#### Routine Maintenance Service Fee

Cedar Lake Park reported Routine Maintenance Service expense of \$9,300 for the test period and proposed no adjustment to this expense. Since the contract is between mutually-owned companies, Cedar Lake Park and Andriot-Davidson's Service Company,

Inc., ("Andriot-Davidson") the transaction is, by definition, at less-than-arms-length. Therefore, the burden of proof is on Cedar Lake Park to demonstrate that the monthly charge for routine maintenance service is fair, just and reasonable.

At the hearing, Cedar Lake Park's President, Mr. Carroll Cogan, testified that a reevaluation of the service requirements and expense levels necessary to adequately operate Cedar Lake Park was undertaken which resulted in the routine maintenance service fee being increased in April, 1982, from \$545 per month to \$755 per month.<sup>2</sup> However, Mr. Cogan admitted upon cross-examination that Andriot-Davidson serviced Cedar Lake Park previous to his taking ownership of Cedar Lake Park's stock and he was, therefore, aware of the service requirements necessary to operate Cedar Lake Park. Mr. Cogan contended that, in many instances, adequate levels of service cannot be agreed upon or provided by the service company because of disputes with the owners of sewer utilities as to the necessary service levels required, and that full control of the plant (by the service company) may be necessary before proper maintenance levels can be determined.<sup>3</sup> However, Mr. Cogan provided no specific evidence to indicate that Cedar Lake Park was not being properly maintained either before his ownership or before this fee was increased in 1982. Mr. Cogan also stated that

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<sup>2</sup> Transcript of Evidence ("T.E."), January 29, 1985, pages 33-36.

<sup>3</sup> Ibid.

Cedar Lake Park did not consider alternatives other than paying the increased charges to Andriot-Davidson.<sup>4</sup>

In evaluating the reasonableness of the routine maintenance service fee in cases involving sewer utilities the Commission often compares the present fee to the level of this fee which was found reasonable in previous Commission Orders. In this instance, Cedar Lake Park's most recent rate Orders in Case No. 7931 (Notice of Adjustment of Rates of Cedar Creek Sewer Company, Inc., d/b/a Cedar Lake Park Sewer System to Become Effective on August 22, 1980) allowed a routine maintenance service fee of \$5,940 per year. A review of Cedar Lake Park's annual reports since 1980 indicates that Cedar Lake Park has experienced only minor increases in its customer base and that Cedar Lake Park has made no additions to plant since the Commission's Order was entered in the previous rate case. Furthermore, there is no evidence to indicate that the increases in this fee above the \$5,940 expense found reasonable in December, 1980, are related to increased levels of services provided by Andriot-Davidson.

It is the responsibility of this Commission to determine whether Cedar Lake Park has shown its expense for routine maintenance service to be fair, just and reasonable. Based on the evidence of record, the Commission is of the opinion that Cedar Lake Park has failed to make such a showing. Therefore, the Commission has made an adjustment which reflects a level of expense equal to the level found reasonable in Cedar Lake Park's

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<sup>4</sup> Ibid., page 38.

previous case. Such adjustment reflects an annual expense level of \$5,940 or a decrease of \$3,360 from the actual test year expense.

#### Miscellaneous General Expenses

Cedar Lake Park had miscellaneous general expenses of \$255 for the test period. In response to Commission requests, Cedar Lake Park stated that these expenses were service charges payable to its affiliate, Andriot-Davidson. At the hearing, Mr. Cogan testified that these late payment charges are determined at an annual interest rate of 18 percent 60 days after an account payable has been incurred. Although Mr. Cogan testified that these service charges are minimized by attempting to pay off accounts payable as fast as possible, the Commission notes that Cedar Lake Park was lending money to associated companies at the same time it was incurring late payment charges.<sup>5</sup> As the Commission is not convinced that these service charges were incurred prudently and for just cause, the Commission has disallowed these charges as an operating expense for rate-making purposes.

#### Interest Expense on Long-Term Debt

Cedar Lake Park had interest expense on long term debt of \$3,795 for the test period. The Commission in Case No. 7931 disallowed this expense, stating, "the related debt obligation results from the applicant's purchase of its common stock as treasury stock" and "this was not an arms-length transaction but a

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<sup>5</sup> T.E., pages 61 and 62.

transaction consummated only because of the mutual ownership of applicant and the seller of the stock, Cogan Company, Inc." <sup>6</sup> Subsequently, Cedar Lake Park's petition for rehearing on this matter was denied by the Commission on January 28, 1981. In this proceeding, Cedar Lake Park was asked to provide any supporting evidence to justify including this expense for rate-making purposes at this time. Cedar Lake Park responded by asking the Commission to reconsider its original disallowance of this expense and asked for a formal conference regarding this issue. Because of Cedar Lake Park's request the Commission ordered that a hearing be held.

At the hearing, Mr. Cogan testified that the stock purchase of Cedar Lake Park by the Cogan Company, Inc., was an arms-length transaction and was similar to other purchases of sewer utilities made by Mr. Cogan, and approved by the Commission, in which interest expense had been allowed for rate-making purposes.<sup>7</sup> Mr. Cogan cited a recent case involving Stonebrook Sanitation Company, Incorporated, ("Stonebrook") as an example where interest expense had been allowed. Upon cross-examination, Mr. Cogan admitted that the effect of the sale and the proposal to include interest expense in this case would be to make the ratepayers bear the cost of financing the purchase of assets already owned by Cedar Lake Park, since Cedar Lake Park had no long-term debt and no interest expense immediately prior to being acquired by Cogan Company,

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<sup>6</sup> Case No. 7931, Order entered August 22, 1980, page 3.

<sup>7</sup> Ibid., page 9.

Inc., in 1979.<sup>8</sup> Moreover, the Commission notes from its Order dated November 3, 1983, in the recent Stonebrook case<sup>9</sup> that the interest expense adjustment proposed in the Stonebrook case was related to the funding for purposes of reconstruction of the system and was not related to the stock purchase of Stonebrook approved in a prior case. The Commission has reviewed the evidence of record filed in this case and finds no reason to change its previous decision on this issue. Therefore, the Commission has again disallowed this expense for rate-making purposes.

#### Other Interest Expenses

Included in test period expenses was \$109 of interest expense on income taxes owed. The Commission notes that Cedar Lake Park had a positive cash flow in 1983. Moreover, the Commission notes that this interest penalty related to 1982 tax expense. Therefore, the Commission is of the opinion that this amount should not be recognized as a test period operating expense and it has thus been disallowed for rate-making purposes.

#### Insurance Expense

Insurance expenses of \$623 for the test period included \$198 for term life insurance premiums for the President of Cedar Lake Park. At the hearing Mr. Cogan testified that his estate is

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<sup>8</sup> Ibid., page 30.

<sup>9</sup> Case No. 8770, Application of Stonebrook Sanitation Company, Inc. for Consideration of a Rate Adjustment and a Certificate of Convenience and Necessity to Construct Improvements to Existing Facilities and Authority to Borrow Funds Necessary for Such Purpose.



the beneficiary of this policy, which was effected to ensure that the stock purchase is accomplished. Because the Commission has disallowed the interest expense on this purchase as an improper item for the ratepayers to bear, the Commission is of the opinion that the insurance expense related to this purchase is not a proper expense to be borne by the ratepayers. The Commission has therefore reduced test period insurance expenses by \$198.

Maintenance of Treatment and Disposal Plant

Cedar Lake Park had maintenance of treatment and disposal plant expenses of \$4,916 for the test period. The Commission staff has reviewed invoices submitted to substantiate these expenses and has determined that some of the expensed items should properly have been capitalized as they will benefit future periods. A breakdown of these items is as follows:

<u>Item &amp; Invoice No.</u>	<u>Date</u>	<u>Amount*</u>
Rebuilt pump #409-26	4-09-83	\$ 785.69
Rebuilt Motor	9-15-83	135.00
Time Clock 1024-28	10-24-83	217.60
Drive Chain 1118-1	11-18-83	318.68
Drive Chain 1231-12	12-31-83	374.52

The Commission is of the opinion that these items totalling \$1,831 should have been capitalized and depreciated over 5 years. This

\* Includes Material, Labor and Mileages, and Tax.

adjustment reduces maintenance expenses by \$1,831 and increases depreciation expense by \$366 for a net reduction in expenses of \$1,465.

#### Income Tax Expense

Cedar Lake Park projected income tax expense of \$2,193 based upon the level of net income requested. The Commission has included tax expense of \$1,912 which includes federal, state and Jefferson County income taxes, an adjustment of \$281.

Therefore, the adjusted operations of Cedar Lake Park are stated as follows:

	<u>Cedar Lake Park Revised Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 50,816	\$ 2,989	\$ 53,805
Operating Expenses	<u>50,234</u>	<u>(5,892)</u>	<u>44,342</u>
Net Operating Income	\$ 582	\$ 8,881	\$ 9,463
Interest Income	1,519	-0-	1,519
Interest Expense	<u>3,904</u>	<u>(3,904)</u>	<u>-0-</u>
Net Income (Loss)	<u><u>\$ (1,803)</u></u>	<u><u>\$ 12,785</u></u>	<u><u>\$ 10,982</u></u>

#### REVENUE REQUIREMENTS

The Commission is of the opinion that a fair, just and reasonable operating ratio is 88 percent in that it will permit Cedar Lake Park to pay its operating expenses, service its debt, and provide a reasonable return to its owners. In this instance the use of an 88 percent after-tax operating ratio applied to the adjusted test year operating expenses results in a revenue requirement of \$50,128 which is less than the actual test period revenues including interest income of \$1,519. Therefore the Commission is of the opinion that no increase is necessary in this case.

### SUMMARY

On January 15, 1985, Cedar Lake Park submitted notice to the Commission of its intent to begin charging the rate advertised in its original application as of February 25, 1985. In its Order of February 22, 1985, the Commission ordered Cedar Lake Park to maintain its records in such manner as would enable it, or the Commission, or any of its customers, to determine the amounts to be refunded and to whom due in the event a refund is ordered upon final determination of this case in accordance with 807 KAR 5:076, Section 8.

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rate proposed by Cedar Lake Park is unfair, unjust and unreasonable in that it would produce revenues in excess of those found reasonable herein and should be denied.

2. The rate of Cedar Lake Park in effect under authority of the Commission prior to the date of this Order is the fair, just and reasonable rate for sewer service.

3. The rate charged by Cedar Lake Park on and after February 25, 1985, is in excess of the rate approved herein, and therefore, the difference should be refunded to the appropriate customers.

IT IS THEREFORE ORDERED that the rate requested by Cedar Lake Park be and it hereby is denied.

IT IS FURTHER ORDERED that the revenues collected by Cedar Lake Park subsequent to February 25, 1985, through rates in excess of those found reasonable herein shall be refunded in the first billing after the date of this Order.

IT IS FURTHER ORDERED that Cedar Lake Park shall file a statement within 30 days of the date of this Order reflecting the number of customers billed, the amount collected under the rate put into effect on February 25, 1985, the number of customers receiving a refund, the amount refunded and the date of the refund.

IT IS FURTHER ORDERED that the rate of Cedar Lake Park in effect under authority of the Commission prior to the date of this Order shall remain in full force and effect.

Done at Frankfort, Kentucky, this 28th day of March, 1985.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary